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June 22, 2005

BY FAX AND FEDEX

James P. Mayer
Executive Director
Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

Re: Inquiry re Governor's Energy Agency Reorganization Plan

Dear Mr. Mayer:

This letter responds to your inquiry dated May 31, 2005. On behalf of the Milton Marks Commission on California State Government Organization and Economy, you asked whether changes proposed by the Governor's Energy Agency Reorganization Plan to move certain functions of the California Public Utilities Commission to the California Energy Commission or the proposed Department of Energy may be accomplished pursuant to the reorganization process established in Government Code section 12080 et seq.¹

The California Public Utilities Commission (CPUC) is in pertinent part a creature of the California Constitution, and the Constitution confers on the CPUC the authority to set rates for public utilities. Accordingly, to the extent that the proposed changes involve transferring rate-making functions from the CPUC to the California Energy Commission or the proposed Department of Energy, such transfers exceed the scope of the reorganization statute. To the extent that the proposed changes do not interfere with the CPUC's rate-making authority, the transfers are within the limits of the reorganization statute.

ANALYSIS

The Milton Marks "Little Hoover" Commission on California State Government Organization and Economy (Commission) is charged with promoting economy, efficiency, and

¹ Unless otherwise indicated, all statutory references herein are to the Government Code.

James P. Mayer
June 22, 2005
Page 2

improved service in state government agencies. (Gov. Code, §§ 8501-8542; see *State Bd. of Education v. Honig* (1993) 13 Cal.App.4th 720, 738, fn. 8; *Commission on Cal. State Gov. Org. & Econ. v. Fair Political Practices Com.* (1977) 75 Cal.App.3d 716, 720-722.) Pursuant to its authority under section 8523, the Commission is currently reviewing the Governor's Energy Agency Reorganization Plan (Plan). Among other things, the Plan proposes to create a Department of Energy and to transfer certain functions now performed by the CPUC to the California Energy Commission or the new Department of Energy. You have asked whether these functions may be so transferred, given the limitations of the reorganization statute, section 12080 et seq.² Though the answer is not free from doubt, we conclude that the reorganization statute cannot be used to transfer to other agencies functions intertwined with and required for the meaningful performance of the rate-making function conferred on the CPUC by article XII of the California Constitution. (Gov. Code, § 12080.4, subd. (e).)

The reorganization statute requires the Governor, from time to time, to examine the organization of all agencies and determine what changes are necessary to accomplish several purposes set out in the statute. (Gov. Code, § 12080.1.) If the Governor finds that reorganization is in the public interest, the statute requires that he or she prepare a reorganization plan and deliver it to the Legislature. (Gov. Code, § 12080.2.) Section 12080.3 specifies the required contents of the reorganization plan. Section 12080.4 specifies what cannot be included in a reorganization plan. Germane to the question you have asked this office to address is subdivision (e), which provides:

"No reorganization plan shall provide for, and no reorganization under this article shall have the effect of:

"(e) Abolishing any agency created by the California Constitution, or abolishing or transferring to the jurisdiction and control of any other agency any function conferred by the California Constitution on an agency created by that Constitution."

² We have not been asked, and therefore do not address, either the Plan's other proposals to transfer functions from other agencies to the Department of Energy or how the proposals considered herein might affect a transfer of functions from other agencies.

The CPUC is an agency created by the California Constitution.³ (Cal. Const., art. XII, § 1; see *California Motor Transport Co. v. Railroad Commission* (1947) 30 Cal.2d 184, 188.) Under the above quoted section, the question you have asked turns on whether the functions the Plan proposes to transfer from the CPUC to the new Department of Energy or the California Energy Commission are constitutionally conferred. If so, these functions cannot be transferred by means of the reorganization statute; if not, they can be transferred to the jurisdiction and control of other agencies through the reorganization process.

Article XII, section 6, of the California Constitution provides that the CPUC "may fix rates, establish rules, examine records, issue subpoenas, administer oaths, take testimony, punish for contempt, and prescribe a uniform system of accounts for all public utilities subject to its jurisdiction." This rate-making authority has been broadly construed to include "the duty of supervising and regulating public utility services and rates." (*California Motor Transport Co. v. Railroad Commission*, *supra*, 30 Cal.2d 184, 188.) The powers available to the CPUC to carry out its constitutional duties have been interpreted to have similar breadth. (*Ibid.*; *People v. Western Air Lines, Inc.* (1954) 42 Cal.2d 621, 634.)

Article XII, section 3, of the California Constitution provides in pertinent part that: "Private corporations and persons that own, operate, control or manage . . . the production, generation, transmission, or furnishing of heat, light, water, power . . . directly or indirectly to or for the public . . . are public utilities subject to control by the Legislature. . . ."

Thus, the CPUC has broad constitutional authority to fix the rates for energy utilities. Under section 12080.4, subdivision (e), transfer of rate-making functions cannot be accomplished through a reorganization. What comprises the rate-making function, however, and whether the functions the Plan seeks to transfer come within it, are questions of first impression for which there is no bright-line rule. On the one hand, it is well-established that the rate-making function includes not just the power expressly granted to set rates, but the exercise of such additional powers necessary for the due and efficient administration of those powers, or as may fairly be implied from those powers. (See *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 824.) Statutory authority must be so construed to achieve its object. (*Dickey v. Raisin Proration Zone* (1944) 24 Cal.3d 796, 810.) On the other hand, the CPUC's authority to set rates does not extend to every matter that might conceivably affect retail rates. For example, the CPUC is not free to relieve utilities subject to its regulation from the regulations of other agencies that are generally applicable to utilities and other businesses in the state, even though other regulations

³ The CPUC also meets the definition of an "agency" in the reorganization statute: it is a commission in the executive branch of state government, the primary function of which is not to serve the Legislature or the judicial branch, and it is not administered by an elective officer. (Gov. Code, § 12080, subd. (a).)

may cause utilities to incur costs that might affect rates. (See *Orange County Air Pollution Control Dist. v. Public Utilities Commission* (1971) 4 Cal.3d 945, 953-54.) Also, the CPUC sometimes shares responsibility with other agencies for certain aspects of utility regulation that do not directly address cost recovery or rate making. (See *County of Sonoma v. State Energy Resources Conservation & Development Com. (County of Sonoma)* (1985) 40 Cal.3d 361, 364-365 & fn.3. [noting that CPUC cannot grant a certificate of public convenience and necessity for siting a thermal power plant until California Energy Commission issues certificate and that the latter's determination of matters in Public Utility Code section 1001 is conclusive on the CPUC].) Accordingly, there is some regulation that may indirectly affect rates which does not intrude on the constitutional rate-making authority of the CPUC. What the permissible scope of that authority might be, however, has not been tested. In addition, the reorganization statute not only prohibits the transfer of a constitutional function to another agency's jurisdiction, but also prohibits the transfer of the control of that function to another agency. (Gov. Code, § 12080.4, subd. (e).)

Because the courts have broadly interpreted the rate-making authority of the CPUC in general, because rules of statutory construction hold that functions implied in, or necessary to the exercise of, express statutory authority are included in the authority conferred, and because the reorganization statute restricts the transfer of constitutionally conferred functions to the jurisdiction and control of another agency, we conclude that the CPUC's rate-making function should be construed to comprise functions implied in, or necessary to the exercise of, the California Constitution's express grant of rate-making authority to the CPUC, and that such functions cannot be transferred to another agency under the authority of the reorganization statute.

Review of the Plan mockup provided on the Commission's web site⁴ reveals the following proposed transfers of five functions currently performed by the CPUC. According to the standard set forth above, analysis of the question presented with respect to each of these five proposed transfers immediately follows the description of each proposed statutory amendment.

1. Amendments to Public Utilities Code section 335, subdivision (f).

This proposal (see mockup at pp. 133-134) would transfer from the CPUC to the Department of Energy's Office of Energy Market Oversight (OEMO) responsibility for serving as a representative of California consumers "in all proceedings before the Federal Energy Regulatory Commission," except as permitted by the OEMO.

⁴ See <http://www.lhc.ca.gov/lhcdir/EnergyGRPStatutoryDraft.pdf>.

The CPUC's authority to participate in FERC proceedings as the representative of California consumers is not a function explicitly given to the CPUC by the Constitution. However, some opportunity and responsibility to represent California consumers before FERC is, in our view, necessary to the meaningful exercise of the CPUC's rate-making authority. With very limited exceptions, under the federal "filed rate doctrine," wholesale rates set at FERC are directly passed through to retail rates and ratepayers. (See *Nantahala Power & Light Co. v. Thornburg* (1986) 476 U.S. 953; see also *Pacific Gas & Elec. Co. v. Lynch* (N.D. Cal. 2002) 216 F.Supp.2d 1016.) Due to the ongoing expansion of FERC authority, it is increasingly the case that determination of wholesale rates is virtually tantamount to the setting of retail rates. Thus, one of the ways that the CPUC "sets" retail rates is by participating in rate-making and rate design proceedings at FERC. For this reason, the Federal Power Act gives state public utilities commissions standing to participate in its wholesale rate-making proceedings. (See, e.g., 16 U.S.C. §§ 824d(e), 824e(b) and (d), 824h(b), 825(a).) This is not to say that the CPUC's representation of ratepayers at FERC is exclusive.⁵ But because this proposed amendment would interfere with the CPUC's participation in wholesale rate making and rate design at FERC by putting that participation entirely within the control of the OEMO, we conclude that it is prohibited by section 12080.4, subdivision (e).

2. Amendments to Public Utilities Code section 365, subdivision (a).

This proposal (see mockup at pp. 141-142) would transfer from the CPUC to the OEMO responsibility for participating "fully in all proceedings before the Federal Energy Regulatory Commission in connection with the Independent System Operator and the independent Power Exchange," and encouraging "the Federal Energy Regulatory Commission to adopt protocols and procedures that strengthen the reliability of the interconnected transmission grid, encourage all publicly owned utilities in California to become full participants, and maximize enforceability of such protocols and procedures by all market participants."

The analysis here is the same as the analysis of the proposed amendment discussed immediately above. Proceedings at FERC with respect to the Independent System Operator and the (now defunct) Power Exchange, to the extent that they involve rate making or rate design, are closely intertwined with the constitutionally conferred rate-making function and cannot be transferred without limitation to the OEMO pursuant to section 12080.4, subdivision (e).

⁵ Although we are not informed of the full range of the CPUC's participation at FERC, this participation has not been limited to rate-making and rate-design proceedings. To the extent that the Plan seeks to transfer from the CPUC the ability to participate in other kinds of FERC proceedings, it does not appear that section 12080.4, subdivision (e) would be an impediment.

Nevertheless, because these proceedings encompass more than rate making or rate design, the OEMO may also be given authority to participate in these FERC proceedings.

3. Amendments to Public Utilities Code section 464, subdivision (b).

This proposal (see mockup at pp. 159-160) would transfer from the CPUC to the OEMO responsibility for facilitating "the efforts of the state's transmission owning electrical corporations to obtain authorization from the Federal Energy Regulatory Commission to recover reasonable expenditures made for the purposes stated in subdivision (a)."

The analysis here is the same as the analysis of the two proposed amendments discussed above. Proceedings at FERC regarding cost recovery (here, to plan, design, engineer reconfiguration, replacement or expansion of transmission facilities) are a necessary part of the process of setting wholesale rates, which are the most significant component of retail rates. Accordingly, the CPUC's participation therein is an implied component of its constitutionally conferred rate-making function and the reorganization process cannot be used to exclude the CPUC from this participation at FERC pursuant to section 12080.4, subdivision (e). As set forth above, however, the OEMO may also be given authority to participate in these proceedings.

4. Amendments to Public Utilities Code section 1001, subdivision (b).

This proposal (see mockup at p.160) would transfer from the CPUC to the exclusive jurisdiction of the Department of Energy "all responsibilities of the [CPUC] with respect to the certification of a natural gas line, storage facility, plant or system, or any extension thereof, and with respect to an electric transmission line, plant or system, or any extension thereof, carrying electricity to the interconnected grid or that is part of the interconnected grid, but not including electric distribution facilities All applications for the certification regarding any line, facility, plant or system described in this subdivision shall be heard and decided by the California Energy Commission with the Department of Energy. A decision of the Department of Energy or the California Energy Commission with respect to matters transferred pursuant to this subdivision shall be conclusive as to all matters determined thereby, and judicial review of any such decisions shall be governed by section 25531 of the Public Resources Code. . . ."

The analysis of this proposed amendment tracks that of the amendment discussed immediately below. The "responsibilities" referred to include cost recovery determinations which are necessary to the exercise of the CPUC's rate-making functions, and which this amendment would make "conclusive" on the CPUC. Therefore, transfer of the rate-making functions from the CPUC to the California Energy Commission or the Department of Energy,

and the conclusive effect of those determinations on the CPUC, is prohibited by section 12080.4, subdivision (e).

5. Amendments to Public Utilities Code section 1001, subdivision (c).

This proposal (see mockup at p. 161) would transfer from the CPUC to the California Energy Commission responsibility for considering and making "any necessary findings on all factors required by sections 1001 through 1005.5 of this title and any other provision of law, including the anticipated effect of any proposed project on consumer rates and on the environment, as well as the public benefits expected to result from any project."

Public Utilities Code sections 1001 through 1005.5, to which this amendment refers, govern the requirements for construction or extension of facilities. These sections encompass the following provisions that are necessary and intrinsic to the rate-making function:

a) Section 1003, subdivision (c), requires, in connection with an application for certification, that the applicant utility submit "an appropriate cost estimate, including preliminary estimates of the costs of financing, construction, and operation, including fuel, maintenance, and dismantling or inactivation after the useful life of the plant, line or extension."

b) Section 1003, subdivision (d), requires, in connection with an application for certification, that the applicant utility submit "[a] cost analysis comparing the project with any feasible alternative sources of power. The corporation shall demonstrate the financial impact of the plant, line or extension construction on the corporation's ratepayers, stockholders, and on the cost of the corporation's borrowed capital. The costs analyses shall be performed for the projected useful life of the plant, line, or extension, including dismantling or inactivation after the useful life of the plant, line, or extension."

c) Section 1005, subdivision (b), provides: "When the [CPUC] issues a certificate for the new construction of a gas or electric plant, line or extension, the certificate shall specify the operating and cost characteristics of the plant, line, or extension, including, but not limited to, the size, capacity, cost, and all other characteristics of the plant, line, or extension which are specified in the information which the gas and electrical corporations are required to submit, pursuant to Section 1003 or 1003.5."

In its 1982 amendments to chapter five of the Public Utilities Code, which governs certificates of public convenience and necessity, the Legislature intended "[t]o provide the [CPUC] with sufficient reliable information to enable it to fulfill its functions to establish fair and equitable rates to cover prudent and reasonable costs incurred by electric and gas public

James P. Mayer
June 22, 2005
Page 8

utilities in the construction of electric and gas plants." (Stats.1982, c. 1253, § 1, subd. (c), p. 4595.⁶) In light of the Legislature's explicit recognition that these provisions are designed specifically to help the CPUC fulfill its constitutionally conferred rate-making function, we conclude that these functions cannot be transferred from the CPUC to the California Energy Commission under section 12080.4, subdivision (e).

The reorganization statute would permit those transfers of authority that do not interfere with the CPUC's exercise of its rate-making authority. For example, under the Warren-Alquist State Energy Resources Conservation and Development Act, the California Energy Commission has responsibility for the siting function for thermal energy plants and related transmission lines, but those responsibilities do not extend to the rate-making functions that are part of siting. (See Pub. Resources Code, §§ 25500, 25119, 25110, 25120, 25107; Pub. Util. Code, § 1002; *County of Sonoma, supra*, 40 Cal.3d 361, 364-365 & fn. 3.)

In summary, the reorganization statute prevents the transfer of constitutionally conferred rate-making authority from the CPUC to the jurisdiction and control of either the proposed Department of Energy or the California Energy Commission as contemplated by the Plan. The reorganization process may be used, however, to transfer to other agencies functions that do not compromise the CPUC's authority to set rates for public utilities.

Sincerely,

A handwritten signature in black ink, appearing to read "Tamar Pachter", with a stylized, flowing script.

TAMAR PACHTER
Deputy Attorney General

For BILL LOCKYER
Attorney General

⁶ The 1982 enactment amended section 1005, added sections 1003 and 1003.5, and added article five, including sections 1091 through 1101, of the Public Utilities Code. (See Stats.1982, c. 1253.)